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No. 07-998

IN THE

Supreme Court of the United States

CIRCUIT CITY STORES, INC.,

Petitioner,

v.

ROBERT GENTRY,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of California

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

In its Petition, Circuit City Stores, Inc. ("Circuit City") showed that the refusal of the California Supreme Court, based on state labor law policies, to enforce the parties' agreement to arbitrate individually conflicts with decisions of five federal circuit courts and the decisions of this Court interpreting Section 2 of the Federal Arbitration Act ("FAA"). Pet. 3, 15-24. Circuit City further showed that the unconscionability ruling by the court below conflicted with this Court's decisions and a decision of the Third Circuit because the California Supreme Court impermissibly applied arbitration-specific standards to conclude that the arbitration agreement was procedurally unconscionable. *Id.* at 4, 24-30.

Since filing its petition, Circuit City's position has been reaffirmed by this Court in *Preston* v. *Ferrer*, 128 S. Ct. 978 (2008). In *Preston*, this Court held that, under the FAA, an agreement to arbitrate could neither be deferred nor avoided based on California's Talent Agency Act because that law impermissibly "imposes prerequisites to enforcement of an arbitration agreement that *are not applicable to contracts generally*." *Id.* at 985 (following *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996)). The *Preston* Court held that the California law was preempted by Section 2 of the FAA because it "frustrated" and "hinder[ed] speedy resolution of the controversy" in accordance with the parties' agreement to arbitrate. *Id.* at 986. That is what the California Supreme Court has done here: By refusing to enforce the parties' agreement to arbitrate individually and instead remanding for further proceedings that do not apply to "any contract," and

further, by establishing an "arbitration-specific" test for procedural unconscionability, the decision below violates the FAA and thus warrants further review and reversal by this Court.

Respondent's brief in opposition ("Opp.") does not address the holding in *Preston*. Nor can respondent deny that the decision below is vitally important given the multiple *amici* explaining the profound impact that the California Supreme Court's decision would have if left unreviewed by this Court. *See* Brief of *Amicus Curiae* of the Chamber of Commerce of the United States of America at 3 (explaining that decision below throws into "jeopardy" the "validity of millions of contracts reflecting the intent of parties to arbitrate"); Brief of *Amicus Curiae* of Pacific Legal Foundation at 3 ("California's hostility toward arbitration contracts affects many millions of employees and businesses"); Brief of *Amici Curiae* of Ace American Ins. Co. et al. at 3, 5-6 (explaining "widespread implications" of questions presented).

Instead, respondent adopts a scattershot approach, arguing that review should be denied because (i) Circuit City "fail[ed] to raise these issues below," Opp. 2, (ii) there is no "final judgment under 28 U.S.C. § 1257(a)," *id.* at 4, and (iii) there is no conflict on either question because Circuit City has "mischaracteriz[ed] the reasoning of the decision below," *id.* at 2.[1] As shown below, none of these arguments withstands scrutiny.

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[1] Respondent attempts to divert attention from the stark conflicts implicated in this case by arguing that the 1995 version of Circuit City's arbitration rules "drastically limited substantive rights guaranteed by California law." Opp. 6; *id.* at 6-8. That argument – which Circuit City rejects – simply has no bearing on the merits of this petition. Indeed, the court below expressly declined to address Circuit City's showing that later

A. This Court Has Jurisdiction Over The Questions Presented.

1. Respondent's lead argument – *i.e.*, that the "Questions Presented" are not properly before this Court, Opp. 1-2, 11, 13, 17, 23 – is insubstantial.

Respondent contends that "[a]t no stage of the proceedings below did Circuit City argue that an agreement to arbitrate cannot be invalidated by state-law policies other than those that apply to 'any contract.'" *Id.* at 11 (quoting 9 U.S.C. § 2). That is false. In the California Supreme Court, Circuit City argued, point blank:

> Section 2 of the FAA requires state and federal courts to enforce the terms of arbitration contracts, unless they . . . are subject to "such grounds as exist at law or equity for the revocation of any contract." 9 U.S.C. § 2. No "additional limitations under state law" may be applied to invalidate an enforceable arbitration agreement.

Circuit City's Answer Brief ("Answer Brief") at 46 (quoting *Southland Corp.* v. *Keating*, 465 U.S. 1, 10-11 (1984)).

Respondent is likewise wrong in asserting that Circuit City did not advance its unconscionability argument below. Opp. 13, 23. To the contrary, Circuit City relied heavily on *Perry* v. *Thomas*, 482 U.S. 483, 490-91 & n.9 (1987), see Answer Brief at 47-48, and argued, as it does now, that any "arbitration-specific rule would be preempted by the FAA" and that a "contrary rule of 'unconscionability' necessarily

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amendments superseded these challenged provisions. Pet. App. 41a n.11.

would be arbitration-specific, and preempted by the FAA." *Id.* at 50-51.

Further, as a legal matter, "[t]here can be no question as to the proper presentation of a federal claim when the highest state court passes on it." *Raley* v. *Ohio*, 360 U.S. 423, 436-37 (1959); *accord Jenkins* v. *Georgia*, 418 U.S. 153, 157 (1974); Gressman et al., *Supreme Court Practice* 197 (9th ed. 2007) ("Once it is clear that the highest state court has actually passed on the federal question, any inquiry into how or when the question was raised in the state courts is considered irrelevant . . . ."). In its petition, Circuit City highlighted that the California Supreme Court had expressly rejected its position that the FAA foreclosed state-law rules that would deny enforcement of its agreement to arbitrate. Pet. 11 (citing Pet. App. 26a-29a). That decision makes clear that the court below considered and passed on Circuit City's arguments regarding FAA preemption. Pet. App. 26a-27a ("Nor do we accept Circuit City's argument that a rule invalidating class arbitration waivers discriminates against arbitration clauses in violation of the [FAA]."); *id.* at 27a ("We also continue to reject Circuit City's suggestion . . . that compelling class arbitration in the appropriate case violates the FAA.").

2. Equally meritless is respondent's claim that this Court "lacks jurisdiction under § 1257(a)." Opp. 14. The governing rule is that "judgments of state courts that finally decide a federal issue are immediately appealable when [i] 'the party seeking review here might prevail [in the state court] on the merits of nonfederal grounds, . . . [ii] where reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action' . . . and [iii] 'refusal immediately to

review the state-court decision might seriously erode federal policy.'" *Southland Corp.* v. *Keating*, 465 U.S. 1, 6 (1984) (second alteration in original) (quoting *Cox Broad. Corp.* v. *Cohn*, 420 U.S. 469, 483 (1975)).

Applying that framework to the FAA, this Court in *Southland* held that "to delay review of a state judicial decision denying enforcement of the contract to arbitrate until the state-court litigation has run its course would defeat the core purpose of a contract to arbitrate." *Id.* at 7-8; *accord Perry*, 482 U.S. at 489 n.7. Since then, this Court repeatedly has exercised jurisdiction and reversed state court judgments that denied enforcement or made enforcement of agreements to arbitrate contingent on proceedings that would violate the FAA. See, *e.g.*, *Buckeye Check Cashing, Inc.* v. *Cardegna*, 546 U.S. 440, 449 (2006); *Citizens Bank* v. *Alafabco, Inc.*, 539 U.S. 52, 58 (2003) (per curiam); *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 689 (1996); *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 282 (1995).

Respondent asserts that neither *Southland* nor *Perry* "controls because in both, the lower courts had rendered final decisions on the federal questions at issue." Opp. 15. As discussed above, the California Supreme Court unquestionably rendered a final judgment rejecting Circuit City's showing that the FAA preempted state-law rules "compelling class arbitration in the appropriate case." Pet. App. 27a. This Court thus has jurisdiction under § 1257(a) over the judgment of the court below. See *Southland*, 465 U.S. at 6-7; *Perry*, 482 U.S. at 489 n.7.

Respondent suggests that jurisdiction is divested because the decision below leaves open for remand whether Circuit City might be able to enforce its agreement to arbitrate by satisfying the state-law standards that Circuit City contends violate federal

law. See Opp. 15. That possibility, however, is irrelevant because even if "'the party seeking review here might prevail [in the state court] on the merits of nonfederal grounds,'" jurisdiction in this Court is proper. *Southland*, 465 U.S. at 6 (alteration in original). This Court has rejected respondent's argument for cases involving the FAA because delaying review "until the state-court litigation has run its course would defeat the core purpose of a contract to arbitrate." *Id.* at 7-8. Indeed, just last month, in *Preston*, this Court exercised jurisdiction and reversed a state court judgment that did not strike down an agreement to arbitrate, but instead made enforcement of arbitration contingent on preliminary proceedings that were not "applicable to contracts generally." 128 S. Ct. at 985 (following *Doctor's Assocs.*, 517 U.S. at 687).

This Court plainly has jurisdiction over the petition in this case.

B. This Case Implicates A Deep Conflict On Whether Enforcement Of An Arbitration Agreement May Be Refused Based On State Law That Does Not Apply To "Any Contract."

Respondent attempts to dismiss the conflict implicated by the decision below as involving merely "a handful of federal circuit decisions." Opp. 2. But respondent cannot escape that the California Supreme Court's decision makes enforcement of the parties' agreement to arbitrate contingent on application of California labor law, not on principles applicable to "any contract." 9 U.S.C. § 2. As such, the decision below conflicts directly with rulings by five separate federal courts of appeals which hold that enforcement of agreements under the FAA cannot be denied based on a state law that "does not

apply to 'any contract.'" *Bradley* v. *Harris Research, Inc.*, 275 F.3d 884, 890 (9th Cir. 2001) (quoting 9 U.S.C. § 2); see also Pet. 3 (citing conflicting cases).

Respondent does not dispute that these circuits hold that enforcement of the terms of arbitration agreements cannot be avoided based upon state laws that do not apply to "any contract." 9 U.S.C. § 2. Here, however, the California Supreme Court made enforcement of the parties' arbitration agreement contingent on an assessment whether individual arbitration protected by the FAA was consistent with California labor law principles, which the court below called "unwaivable." Pet. App. 10a (interpreting California Labor Code § 1194); see also *id.* at 1a ("we consider whether class arbitration waivers" violate "statutory rights to overtime pay pursuant to Labor Code section 500 et seq. and 1194"); *id.* at 25a (applying strong public policy behind § 1194). As such, the decision below authorizes California courts to disregard the terms of agreements to arbitrate based on whether a court believes that different procedures would be "significantly more effective" in vindicating class members' right to overtime pay. *Id.* at 23a.

That ruling directly conflicts with circuit decisions from across the country, see Pet. 3, and is also flatly inconsistent with this Court's holdings. For example, in *Southland*, this Court reversed the California Supreme Court's refusal to enforce an agreement to arbitrate based on state law that prohibited any agreement "'to waive compliance with any provision'" of state franchise law. 465 U.S. at 10. This Court held that arbitration must go forward because "the California Franchise Investment Law is not a ground that exists at law or in equity 'for the revocation of *any* contract.'" *Id.* at 16 n.11; see also *Perry*, 482 U.S.

at 490-91 (FAA preempts California state policy that precluded arbitration of labor disputes).

Respondent insists, however, that there is no conflict. He claims that the decision below does not refuse to enforce the arbitration agreement based on State labor law but instead is an application of a "'generally applicable contract defense'" "codified in California Civil Code § 1668, which expressly indicates its *universal application*." Opp. 19 (emphasis added). That is wrong because the California Supreme Court's decision expressly relied upon and applied "the strong public policy behind section 1194" of California Labor Code. See Cal. Labor Code § 1194; Pet. App. 25a. In any event, contrary to respondent's argument, Section 1668 does *not* have "universal application" and is thus not grounds under California law "for the revocation of any contract." 9 U.S.C. § 2. Indeed, the California Supreme Court has held that § 1668 applies only to the subset of contracts that involve the "public interest." *Tunkl* v. *Regents*, 383 P.2d 441 (Cal. 1963).[2]

C. The Unconscionability Ruling Conflicts With Decisions Of This Court And The Third Circuit.

Review also should be granted because the California Supreme Court's unconscionability ruling

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[2] *See also Vilner* v. *Crocker Nat'l Bank* 89 Cal. App. 3d 732, 735 (1979) ("Despite its broad language, section 1668 does not apply to every contract"); *accord Cregg* v. *Ministor Ventures*, 148 Cal. App. 3d 1107, 1111 (1983) ("[Section 1668] will be applied only to contracts that involve 'the public interest.'"); 1 Witkin, *Summary of California Law* § 660, at 737-38 (10th ed. 2005) (Section 1668 does not apply to contracts where "no public interest is involved").

adopts an arbitration-specific rule in violation of this Court's decisions in *Perry* and *Doctor's Associates*, and in conflict with the Third Circuit's decision in *Gay* v. *CreditInform*, 511 F.3d 369 (3d Cir. 2007).

Respondent denies any conflict, arguing that "unconscionability is a generally applicable contract defense that is *not* preempted by the FAA." Opp. 21. That argument ignores *Perry*, in which this Court explained that "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . § 2," and thus, for example, a court could not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." 482 U.S. at 493 n.9. Relying on *Perry*, the Third Circuit in *Gay* likewise has ruled that a state unconscionability law is not insulated from review under the FAA when it relies on "the uniqueness" of the arbitration provision as a basis for refusing to enforce the terms of the parties' agreement. 511 F.3d at 395. Indeed, respondent acknowledges that the Ninth Circuit has deepened this conflict by "refus[ing] to follow *Gay*." Opp. 25 (citing *Lowden* v. *T-Mobile USA*, 512 F.3d 1213 (9th Cir. 2008)).

Here, the California Supreme Court did not apply generally applicable contract law or conclude that the parties' agreement was procedurally unconscionable because Circuit City "conceal[ed] the unfavorable terms of an agreement." Opp. 22. To the contrary, the majority acknowledged that (i) the terms of the arbitration agreement were set forth in full in Circuit City's "Dispute Resolution Rules and Procedures," Pet. App. 38a, (ii) respondent was given 30 days to review and consider those terms, *id.* at 33a, (iii) respondent was advised that he could "'consult with

an attorney'" about his legal rights, *id.* at 39a, and (iv) respondent expressly acknowledged that his decision whether to participate in the arbitration program was "'voluntary,'" *id.* at 32a. Respondent ignores these undisputed facts in suggesting that the decision below merely employed unconscionability principles that "regularly apply . . . to all manner of contracts." Opp. 22.[3]

What mattered to the court below was that even though Circuit City acknowledged "some of the shortcomings of arbitration in a general sense, it did not mention any of the additional significant disadvantages that *this particular arbitration agreement* had compared to litigation." Pet. App. 37a. That, however, is an impermissible arbitration-specific standard in violation of this Court's ruling that "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . § 2." *Perry*, 482 U.S. at 493 n.9; *accord Doctor's Assocs.*, 517 U.S. at 685. As such, respondent cannot distinguish *Perry*,

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[3] *Cf. Pardee Constr. Co.* v. *Superior Court*, 100 Cal. App. 4th 1081, 1089-90 (2002) (operative paragraph "was difficult to read and misleading" and agreement "omitted mention of the economically significant matter of referee's fees"); *Ilkhchooyi* v. *Best*, 37 Cal. App. 4th 395, 410 (1995) (party affirmatively misled by assurances that term in new lease was "basically the same" as an earlier lease when in fact a new provision had been added in diminutive print in the middle of one of five lengthy paragraphs); *Ellis* v. *McKinnon Broad. Co.*, 18 Cal. App. 4th 1796, 1804 (1993) (party asked to sign form "without warning" and affirmatively told that it was a "'formality'"); *A & M Produce Co.* v. *FMC Corp.*, 135 Cal. App. 3d 473, 489-91 (1982) (provisions procedurally unconscionable when party presented evidence that he was surprised by terms that were "only casually shown to [him]").

Doctor's Associates, or the Third Circuit's ruling in *Gay*.

Lastly, respondent suggests that "employees likely felt pressure *not* to opt out of arbitration" because Circuit City's materials made clear it preferred arbitration. Opp. 22. Under California law, however, the party opposing enforcement of a contract has the affirmative burden of proving unconscionability. *E.g.*, *Brutoco Eng'g & Constr., Inc.* v. *Superior Court*, 107 Cal. App. 4th 1326, 1331 (2003). Here, respondent "signed an easily readable, one-page form that accompanied receipt of the Associate Issue Resolution Package," which explained the procedures if he wanted to *opt out* of arbitration with Circuit City and confirmed that respondent was aware that the program was "'voluntary.'" Pet. App. 32a-33a. Speculation that respondent nevertheless might have "felt pressure" cannot defeat arbitration under the FAA because "[m]ere inequality in bargaining power . . . is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context." *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991).

CONCLUSION

For the foregoing reasons, and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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